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In the Supreme Court of the United States

OCTOBER TERM, 1928

No. 481

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE for the District of Kentucky, petitioner

v.

A. J. A. ALEXANDER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

STATEMENT

The brief for respondent contends that the proceeds of the life insurance policies in this case did not constitute income within the meaning of the Sixteenth Amendment. This question was not dealt with in the brief for the petitioner and this reply brief will be confined to that point.

ARGUMENT

THE AMOUNT REALIZED UPON THE SURRENDER OF LIFE INSURANCE POLICIES BY THE RESPONDENT IS TAXABLE INCOME TO THE EXTENT THAT IT EXCEEDS COST

Respondent seeks to inject into this case the question of whether the proceeds of insurance poli-

cies received by an insured where all premiums were paid prior to March 1, 1913, is taxable income. At the outset he is met by the settled rule that upon certiorari the only question which will be considered by this Court is the ground upon which the petition for the writ of certiorari was based. *Commercial Credit Co.* v. *United States*, 276 U. S. 226, 229. Respondent filed no petition for a writ of certiorari and a party who has not sought review is not entitled to review the part of the judgment of which he complains. *Fed. Trade Com.* v. *Pac. Paper Assn.*, 273 U. S. 52, 66.

However, should this Court find any persuasive reason for considering that question, we submit that when, as in this case, insurance policies matured during the life of the insured and the proceeds are paid to him, the gain upon such disposition of the property is true income within the meaning of that term as defined by this Court. That definition is "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." *Eisner* v. *Macomber*, 252 U. S. 189, 207; *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509, 518.

The policies were fully paid up in this case before March 1, 1913, the aggregate premiums amounting to $78,100. The Commissioner determined that the March 1, 1913, value was no greater. At maturity respondent received in 1919 from the company upon surrender of the policies the sum of $120,797. The

difference between these two amounts was treated as taxable income. In *Penn Mutual Co.* v. *Lederer*, 252 U. S. 523, this Court considered the nature of certain sums paid to policyholders by an insurance company and said (p. 532):

> But after the policy is paid up, the element of investment predominates and Congress might reasonably regard the dividend substantially as profit on the investment.

And in speaking of a policy holder who, like respondent, received a "share of the forfeiture" it was said (pp. 532–533):

> * * * the dividend represents in part what clearly could not be regarded as a repayment of excess premium of the policyholder receiving the dividend. For the "share of the forfeiture" which he receives is the share of the redundancy in premium of other policyholders who did not persist in premium payments to the end of the contract period.

It is evident that respondent's sole investment in the policies was the total premiums paid and that when he received a greater sum upon the surrender of the policies such excess was gain upon the investment or income. "The premium is in the nature of a savings deposit," *Penn Mutual Co.* v. *Lederer*, *supra* (p. 531), and the amount returned in excess of the premiums paid is of the same nature as interest paid by the savings bank.

Respondent relies upon *Gray* v. *Darlington*, 15 Wall. 63, and contends that all that can be taxed

in any annual period is the gain earned and realized in that period. It is true that under earlier Acts only annual income was taxed but that is no longer the practice. Because the language of the Act then under consideration was different in material particulars from that of the more recent statutes, *Gray* v. *Darlington, supra,* is no longer valuable as a precedent upon that point. *Hays* v. *Gauley Mt. Coal Co.,* 247 U. S. 189.

Respondent contends that the money received from the insurance company is a substitute for something which has been lost and assumes that the amount of the premiums could have been invested in securities yielding a higher rate of interest which would have returned on the maturity date of the policies a larger amount than was received from the insurance company. This is not a case of the receipt of proceeds of an insurance policy by a beneficiary. The respondent was the insured and did not receive the proceeds as a replacement of the value of a life. Therefore, the loss to which respondent refers must be the loss of interest upon the amount paid in as premiums. This Court has already decided that, for the purpose of determining net gain or loss in the purchase and sale of stock, interest is not a part of the cost of the assets. *Hays* v. *Gauley Mt. Coal Co., supra.* It was there said (pp. 192–193):

> That the sale resulted in a gain or profit to the extent of $210,000, the difference between the buying and selling prices, is not

> to be doubted, for there is no merit in the contention that interest should be added to the purchase price in order to ascertain its cost. The money that went into the purchase was not loaned at interest; on the contrary, by the very fact of the purchase it was placed where it could not earn interest for the respondent in the ordinary sense, and the gain represented by the increase of selling price over cost price must be regarded as a substitute for whatever return some other form of investment might have yielded.

In the instant case, the insurance protection received during all of the period the policies were in force is an additional substitute for the return some other form of investment might have yielded.

The question of interest was again considered in *Walsh* v. *Brewster*, 255 U. S. 536, 538, which involved bonds purchased in 1902 and 1903 and sold in 1916. The purchaser received no interest until 1906 and contended that interest upon the investment for the time which so elapsed should be added as a part of the cost to him of the bonds. That contention was rejected by this Court upon the authority of *Hays* v. *Gauley Mt. Coal Co., supra.*

It is clear from those decisions that lost interest is not an element to be taken into account in determining gain or loss upon the disposition of property, and we think the principle is equally applicable in determining the gain or loss upon the surrender of life insurance policies by the insured, the result being that all gain over cost is income

within the meaning of the Sixteenth Amendment and within the definition of the term which has been adopted by this Court.

CONCLUSION

In view of the foregoing, it is respectfully submitted that, while the question is not properly presented for the consideration of this Court, yet, in any event, the difference between the premiums paid by the insured and the amount received at maturity by the insured is properly taxed as income.

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MARCH, 1929.

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